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STATE PASS USTR FOR AMBASSADOR SCHWAB, JOHN MELLE, JIM
MENDENHALL, AND SAGE CHANDLER
STATE FOR WHA/CAN
USDOC/ITA/IA/JTERPSTRA

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SUBJECT: CRUNCH TIME COMING FOR SOFTWOOD LUMBER AGREEMENT

REF: OTTAWA 2321

¶1. (SBU) Summary: In his vigorous efforts to garner industry support for the July 1 softwood lumber agreement, International Trade Minister Emerson and other senior Ministers met with top Canadian lumber officials in Toronto on August 9 to hear their concerns about several of the deal's provisions, but he warned that the agreement would not be re-negotiated. While Emerson was publicly optimistic after the meeting that there would be significant Canadian industry support for the deal, he sought to put pressure on the industry to "fish or cut bait" by setting August 21 as the deadline for announcing its support. If sufficient support is not forthcoming, the Minister indicated that the deal would not go forward to get Cabinet approval for Parliamentary action in September, thus killing the agreement. Thus, this week is probably crunch time for the future of the July 1 softwood lumber agreement.

¶2. (SBU) Because of their dominant position in Canadian lumber, the reaction of the British Columbia companies will be key in determining whether Emerson gets the significant industry support he needs to recommend the agreement to Prime Minister Harper and to Parliament. The areas of industrial concern are pretty clear, but it is still uncertain whether these can be addressed satisfactorily (or fudged up) in the "clarifications" that Emerson is now discussing with the industry, the provinces, and USTR. Despite the industry's discontent, the Embassy believes that Emerson, with the Prime Minister's strong support, is adamant that the industry must choose between the July 1 agreement as written and a continuation of trade conflict, uncertainty and litigation.

¶3. (SBU): Comment: The engagement, in the middle of the summer Parliamentary recess, of the senior ministries in last week's Toronto talks underscores the importance of the softwood lumber issue for the Harper government. While resolving the dispute is not on the government's formal list of objectives, contacts have noted to us that it is crucial both to improving Canada-U.S. relations and to demonstrating the Harper team's ability to marshal business support behind a major trade policy initiative. End comment and summary.

Toronto Meeting with the Industry

¶4. (U) On August 9, International Trade Minister David Emerson, Industry Minister Maxime Bernier, and Finance Minister Jim Flaherty met in Toronto for two hours with almost two dozen Canadian lumber executives to discuss industry concerns regarding the U.S.-Canadian softwood lumber agreement that was concluded by Emerson and USTR Susan Schwab

on July 1. After the meeting, Emerson told the press that he was "optimistic" that Ottawa would get "significant" industry support for the agreement by August 21, the date he said he would decide whether to recommend to the Prime Minister and Cabinet that the deal should be submitted to Parliament for its approval after the end of the summer recess on September 18. Emerson warned that he would not move the deal forward without significant industry support. The Minister described the Toronto meeting as constructive, adding that he would continue to meet with the industry, the provinces as well as USTR in coming days to "clarify" wording and definitions in the July 1 agreement in an effort to address industry concerns, but he remarked pointedly that the agreement would not be opened for re-negotiation as some called for.

August 21 Deadline and Next Parliamentary Hearing

15. (SBU) We understand that Minister Emerson's August 21 deadline was dictated by the amount of time the GOC needs to draft the legislation to implement the export tax component of the agreement in time for Parliament's review in late September. A senior advisor in the Prime Minister's office opined that another reason for the date is that it's time for the industry "to fish or cut bait." Perhaps coincidentally, August 21 is also the date of the final hearing of the House of Commons Standing Committee on International Trade that is reviewing the July 1 agreement. At an earlier hearing on July 31, Emerson stressed that "negotiations have ended," that if the July 1 agreement is rejected, there is no chance that another one can be renegotiated for at least three years, and that a fresh round of the litigation cycle would be "ugly." Expected witnesses at next Monday's hearing include the CEO of Domtar; senior officials from Canfor and

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Weyerhaeuser; the Presidents of the British Columbia (BC) Lumber Trade Council; the Ontario Lumber Manufacturers' Association, and the Quebec Forest Products Council; and attorney Elliot Feldman. The hearing would be an opportunity for major industry players to present their definitive views on the July 1 agreement.

16. (SBU) In recent days, the Embassy and the Consulates have discussed Emerson's August 9 announcement with government and industry contacts. Policy advisors in the Prime Minister's office expect Harper to continue to support Minister Emerson's refusal to re-open the July 1 agreement to amendment, despite industry dissatisfaction with some of its provisions. However, key contacts at industry associations were split on whether the GOC will or will not receive sufficient industry support in coming days to go forward with implementing the agreement.

Optimists Versus Pessimists

17. (SBU) The "optimistic" view of industry observers is: "The deal is absolutely essential not just for the industry, but for Canada-U.S. relations and in order to demonstrate that this government has the ability to complete an international treaty. It won't be easy and there will be lots of acrimony, but the stakes are high enough that many parties will sign on to work the backrooms, persuade the companies, and ensure that the Parliamentary vote on the agreement is based on national interests rather than on party lines." On the other hand, the "pessimistic" view believes: "It will only take one company to scuttle this deal and there are several that can do it. Some of those firms have an interest in dragging out the dispute so that they can pick up distressed assets from their failed competitors. This industry has repeatedly shown that it just cannot speak with one voice - the regional and business diversity is just too great for that to be possible." There also seems to be a split on the agreement depending on company size. Large

companies with interests in both the U.S. and Canada (e.g., Weyerhaeuser and Canfor) favor the agreement whereas some smaller Canadian only companies do not.

The View From Quebec

18. (SBU) In an August 14 conversation with our Consul General in Quebec City, Guy Chevette, President of the Quebec Forest Industry Council, commented on the state of play:

-- the Quebec lumber industry believes that it could reach an agreement with the U.S. without much difficulty, but that the BC industry is the real problem.

-- What Quebec is looking for is "souplesse" or flexibility in three areas: 1) "circumvention" - the existing agreement says that any changes to the "forest industry regime" under the agreement are an infraction. In Chevette's view, this is an overly broad provision as there are some changes that Quebec may need to execute that would have nothing to do with softwood lumber, and such adjustments should not be seen as an "infraction" of the July 1 agreement. He cited as an example that the GOQ will need to address how it handles poor quality lumber within the province. The Quebec industry does not want needed changes in the province to be held hostage to the softwood lumber agreement.

2) interpretive annexes - the Quebec industry feels that adding interpretive annexes would give it the flexibility it needs to sign off on the agreement. 3) the Quebec industry needs to sign off on the agreement. 3) the Quebec industry wants a mechanism that would extend the 23 month limit of the agreement for some additional months. For example, if one side wanted to withdraw from the agreement, then it would give that party 2-3 months to announce who would be members of its delegation that would discuss the intention to withdraw; then a few more months to file an intention to withdraw; and so forth. The idea would be to draw out the disengagement process by several months: "giving up a billion dollars is a lot for an agreement that only lasts 23 months."

19. (SBU) Chevette thought that BC in fact doesn't want an agreement at all. They've got their pine beetle infestation disease ravaging their wood, so they would prefer not to have an agreement, and to flood the U.S. market with their softwood instead. The Quebec industry will meet on August 18 to come to agreement on its position.

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Ontario

10. (SBU) According to Consulate General Toronto soundings, the language on running rules - prospective versus retrospective - and monthly quotas are problematic in the July 1 agreement. Ontario's lumber producers are quite concerned about the agreement's provision to divide Canada's export quota into monthly allotments. Under the present agreement text, if companies do not fulfill their share of the monthly quota, the unused quota is lost and cannot be carried forward. An Ontario Ministry of Natural Resources official said that province's industry would prefer a rolling quota over three months, for example, so that any lost production in a given month could be made up in subsequent months.

11. (SBU) While many contacts have either been silent about what happened at the August 9 meeting or have been unreachable, the Vice President at Abitibi said that Emerson's meeting was "very productive, honest, and open." Ontario Premier McGuinty told the Ambassador on August 14 that the BC industry's position will be key to determining the Canadian industry's support of the July 1 agreement.

The Prairies

¶12. (SBU) There has been little reaction to Emerson's meeting from industry leaders in Manitoba, Alberta, and Saskatchewan. The lumber industry in these provinces is an important sector, but relatively small in the big picture. In the past, these observers have said that they have no choice but to "go with the flow" and support the positions of the bigger players in BC, Ontario and Quebec. However, a Conservative Alberta MP had a different take on the current situation. He told the DCM that he heard that the lumber industry in his province favored the status quo of endless litigation over the July 1 agreement.

British Columbia

¶13. (SBU) A key Consulate Vancouver contact was pessimistic about the outcome of the Emerson meeting. The industry in the west is not on board with the July 1 agreement and believes that the GOC is maneuvering the BC companies to kill the deal and then have them take the blame. This outcome would also avoid the deal becoming the subject of a Parliamentary vote of confidence in the fall, which could force a new election if the Conservatives lost. The BC industry was told that their list of demands for modifications in the July 1 agreement was too long and should be shortened. At the August 9 meeting with Emerson, the BC industry said it wanted: 1) a 12 month standstill; 2) running rules (i.e., the border tax calculation on the date a lumber order is placed versus when it actually crosses the border) should be prospective rather than retrospective; 3) border tax adjustments should be reviewed quarterly rather than monthly; and 4) BC's coastal logging should not be subject to a duty (in concert with the rest of the province).

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